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# building OPPORTUNITY

O&Y PROPERTIES CORPORATION

1998 annual report



**O&Y PROPERTIES**  
CORPORATION



Winspear Business Reference Room  
 University of Alberta  
 1-18 Business Building  
 Edmonton, Alberta T6G 2R6

## 1998 FINANCIAL PERFORMANCE

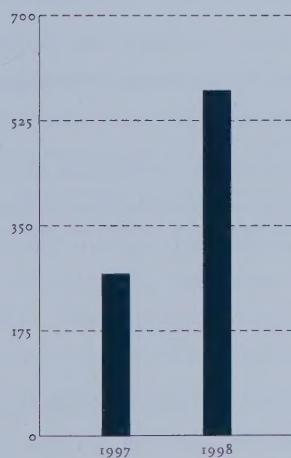
Year ended January 31, 1998

January 31 (in millions of dollars except per share information, percentages and ratios)

|                             | 1998     | 1997     |
|-----------------------------|----------|----------|
| Assets                      | \$ 576.7 | \$ 270.6 |
| Occupancy                   | 95%      | 90%      |
| Cash Flow From Operations   | 19.9     | 13.2     |
| – per share (basic)         | 0.66     | 0.54     |
| – per share (fully diluted) | 0.65     | 0.54     |
| Net Income                  | 18.3     | 12.0     |
| Debt to Equity              | 1.07:1   | 1.40:1   |
| Market Capitalization       | 354.2    | 155.3    |
| Number of Shares (basic)    | 40.7     | 24.3     |
| Shareholders' Equity        | 263.2    | 108.2    |

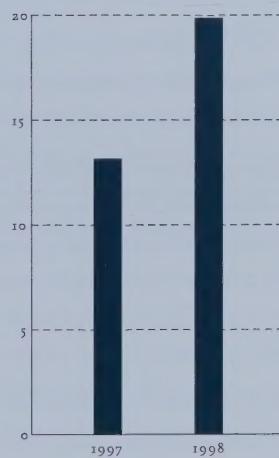
### ASSETS

(in millions of dollars)



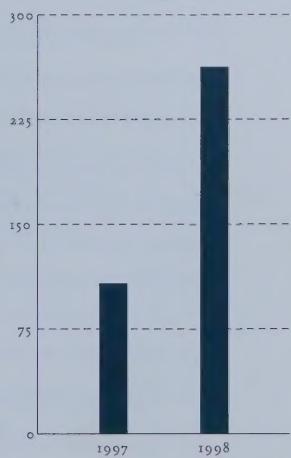
### CASH FLOW FROM OPERATIONS

(in millions of dollars)



### SHAREHOLDERS' EQUITY

(in millions of dollars)



# opportunistic & ENTREPRENEURIAL

For O&Y Properties Corporation and its management team, the fiscal year, ended on January 31, 1998, was an exciting and successful beginning. In our first year under the O&Y Properties banner, we set out to establish ourselves in the Canadian real estate and investment community and demonstrate an ability to raise capital and execute a strategy for growth. We accomplished these objectives through two share offerings and the acquisition of a significant interest in six new properties. With the announcement, since year end, to acquire properties in Western Canada, the Company's portfolio will increase to an interest in 7.6 million square feet of commercial office space.

As the financial highlights on page 1 indicate, we achieved extraordinary success by more than doubling our assets, market capitalization and shareholders' equity. Our debt-to-equity ratio was reduced significantly, providing us with a conservative balance sheet to fuel new growth and to refinance properties in a lower interest rate environment. Most importantly, we established a track record and proved our ability to execute our strategy.

The real estate market was very strong in 1997. As demand side fundamentals grew, property prices increased in most markets. As prices are likely to moderate in 1998 due to more properties being brought to the market, we believe that several acquisition opportunities will be available, particularly through our expanded deal network and enhanced market knowledge. In this environment, O&Y Properties will be positioned to seize these opportunities.

In an evolving market, agility and superior financial engineering skills are critical to success. O&Y Properties believes that its innovative acquisition strategy is an important competitive edge.

Our name symbolizes forty years of experience in real estate. It is this tradition of recognizing and capitalizing on opportunity that has helped us place a strong stake in the ground. It will facilitate our goal of achieving above-average, sustainable growth in our owned properties portfolio while aggressively growing our real estate services business.

## 1998 RESULTS

We are pleased to report strong financial results in fiscal 1998. Cash flow from operations grew by 51%. At \$0.66 on a per share basis, the gain was 22%. Net income, at \$18.3 million, increased 52%.

The financial and operating highlights are described in the 1998 Financial Review section of this annual report. Among the most notable was our acquisition of a 28% interest in First Place Tower Inc. which owns a significant interest in 1 First Canadian Place. This 2.7 million square foot office and retail complex is one of Canada's premier business addresses and the country's tallest office building. In addition to providing the opportunity to participate in the strong downtown Toronto office market, this acquisition provides significant cash flow and rental rate growth potential.

PHILIP REICHMANN  
Chief Executive Officer



Another significant acquisition was a portfolio of three "B+" Class buildings in downtown Toronto totalling 598,000 square feet. As "A" Class buildings in downtown Toronto reach full occupancy and rental rates rise accordingly, tenants will seek alternatives. Typically the preference will be "B" Class properties in "A" locations, or "B+" Class buildings. This will result in higher "B+" occupancy levels and rental rates. When added to our acquisition of a 51.25% interest in 5140 Yonge Street, Toronto in May of 1997 and Acres House in Niagara Falls in November, these transactions increased our owned properties portfolio in the critical Toronto area market. Currently the Company has a substantial interest in six Toronto area office buildings totalling 4.0 million square feet.

Following a March 1997 \$110 million first mortgage bond issue secured by two Ottawa properties, we completed two equity offerings for \$50.8 million and \$55 million in May and October respectively. We ended fiscal 1998 with ownership interests in 6.3 million square feet of commercial office space in Toronto and Ottawa. The Company ended fiscal 1998 with 25 million square feet of office and retail space under management across Canada.

We also had two significant successes on the leasing side of the business. In the summer of 1997, we leased virtually all of the vacant space in 5140 Yonge Street to Trimark Investment Management. With over 200,000 square feet occupied by Trimark, the building will be renamed the Trimark Tower.

The strong office market in Ottawa, driven in part by continued growth in the high tech sector and continuing government consolidation, resulted in a significant lease transaction at Place de Ville. We accomplished two key objectives this year by leasing nearly 200,000 square feet to the Federal Government for a term of 10 years and extending by five years to 2008 the term on approximately 650,000 square feet already occupied by the Government. These transactions reflect our strategy and commitment to be flexible and responsive to the evolving real estate needs of the Government of Canada in the Ottawa region.

During the course of the year, we also disposed of non-core properties. In Kanata we sold over 200 acres of undeveloped land to local developers. In Ottawa we took advantage of the strong hotel market to prepare our remaining hotel property for sale and completed the sale to a hotel real estate investment trust in April 1998.

These and other successes noted in this annual report are the work of an outstanding team of real estate professionals supported by a board of directors with broad experience in the real estate, finance and government sectors.

"OUR NAME SYMBOLIZES FORTY YEARS OF EXPERIENCE IN REAL ESTATE. IT IS THIS TRADITION OF RECOGNIZING AND CAPITALIZING ON OPPORTUNITY THAT HAS HELPED US PLACE A STRONG STAKE IN THE GROUND."

#### DEVELOPMENTS SINCE YEAR END

We are pleased to report to our shareholders that in the first quarter of fiscal 1999, O&Y Properties Corporation has already made considerable progress towards achieving our objectives for the year.

With the completion of the recently announced purchase of the Enterprise Property Group, a privately-owned provider of real estate services to third parties, O&Y Properties will become Canada's largest commercial real estate services company. The deal is expected to add substantially to our revenues and cash flow from operations. Equally significant, the expanded management team that results from this acquisition will be able to focus more intently on property acquisition as well as on real estate services.

The combined company is committed to building a state-of-the-art real estate information delivery system that will allow us to dominate the real estate services industry in Canada. We now have the critical mass, infrastructure, market position and diverse management expertise to lead the Canadian real estate services industry into the next millennium.

Finally, just prior to the publication of this report, we entered into agreements to purchase interests in 1.3 million square feet of office space in Calgary and Winnipeg. These transactions give us a strong presence in Western Canada, advance our objective of achieving geographic diversification in our owned properties portfolio and provide the opportunity to benefit from the strong office market in Calgary. With a wide range of diverse tenants in several industries, this portfolio is both stable in the near-term and well-positioned to realize rental rate growth in the mid- to longer-term.

#### CHALLENGES AND OPPORTUNITIES

As an emerging player, O&Y Properties faces two main challenges.

The first is balancing the near-term expectations with the mid- to long-term objective for growth and sustainable performance. We will meet this challenge by being both opportunistic and entrepreneurial in our approach to value creation. We define "opportunistic" as having the ability to adapt our acquisition strategy quickly in order to seize market opportunities. By "entrepreneurial" we mean having the experience and foresight to assess and take measured, near-term risks for longer-term rewards.

By being opportunistic and entrepreneurial, O&Y Properties is able to buy well, improve the value of properties, realize on peak values and repeat the cycle. We are committed to acquiring, developing and maintaining properties that offer exceptional value to our tenants and building upon the strong and valued reputation of the O&Y brand.

The second challenge is competing against larger companies for both capital and acquisitions. From the perspective of the investment community, our current relatively small size confers a key competitive

FRANK HAUER

*President*

advantage because of the significant impact of acquisitions on our company. It also gives management the flexibility to respond quickly to potential opportunities and to structure innovative transactions.

Another competitive advantage is our acquisition strategy itself. We are focussed primarily on private portfolio vendors who have estate planning objectives and a desire to stay in the game, but also want the ability to exit easily when they choose to do so. The purchase of the Horizon portfolio of three office buildings on Toronto's Yonge Street corridor completed last year is an example of this approach and a template for future acquisitions. This strategy has been repeated with the pending acquisition of Enterprise and the Merit portfolio in the second quarter of this year. You will find a more detailed description of how we are able to seize opportunity in a highly competitive market in the following pages.

Still another success factor is our ability to maintain an optimal risk/return profile in our portfolio by acquiring both Class "A" and Class "B" commercial office properties in Canada. (The former generally offer an opportunity to realize value in the mid- to long-term while the latter generally offer a higher return in the near-term.) We will continue to use this entrepreneurial approach as we grow our portfolio in the future.

Real estate opportunities abound in any market environment – for those companies with the resources, imagination and drive to seize them. O&Y Properties is such a company. We are accumulating the critical mass, financial capital, strategic focus and people necessary to build a solid platform for growth. In a cyclical industry, we are determined to have the capacity to capitalize on opportunities whenever they present themselves.

Finally, we would like to thank all our employees whose dedication, hard work and unparalleled real estate expertise was the foundation of our success in fiscal 1998 and through the first quarter of fiscal 1999. They are truly a winning team. We would also like to thank our many tenants, clients and stakeholders whose confidence and support have contributed to our success. We won't let you down.

A handwritten signature in black ink, appearing to read "P. Reichmann".

**Philip Reichmann**  
*Chief Executive Officer*

A handwritten signature in black ink, appearing to read "F. Hauer".

**Frank Hauer**  
*President*

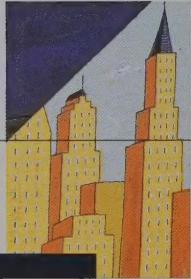
"WE ARE FOCUSED PRIMARILY ON PRIVATE PORTFOLIO VENDORS WHO HAVE ESTATE PLANNING OBJECTIVES AND A DESIRE TO STAY IN THE GAME, BUT ALSO WANT THE ABILITY TO EXIT EASILY WHEN THEY CHOOSE TO DO SO."

# CONTINUOUS growth...

march



may



july



august



september



1997 →

→ ISSUED \$110 MILLION OF  
FIRST MORTGAGE BONDS.

→ COMPLETED A \$50.8 MIL-  
LION PUBLIC OFFERING  
AT \$5.40 PER SHARE.

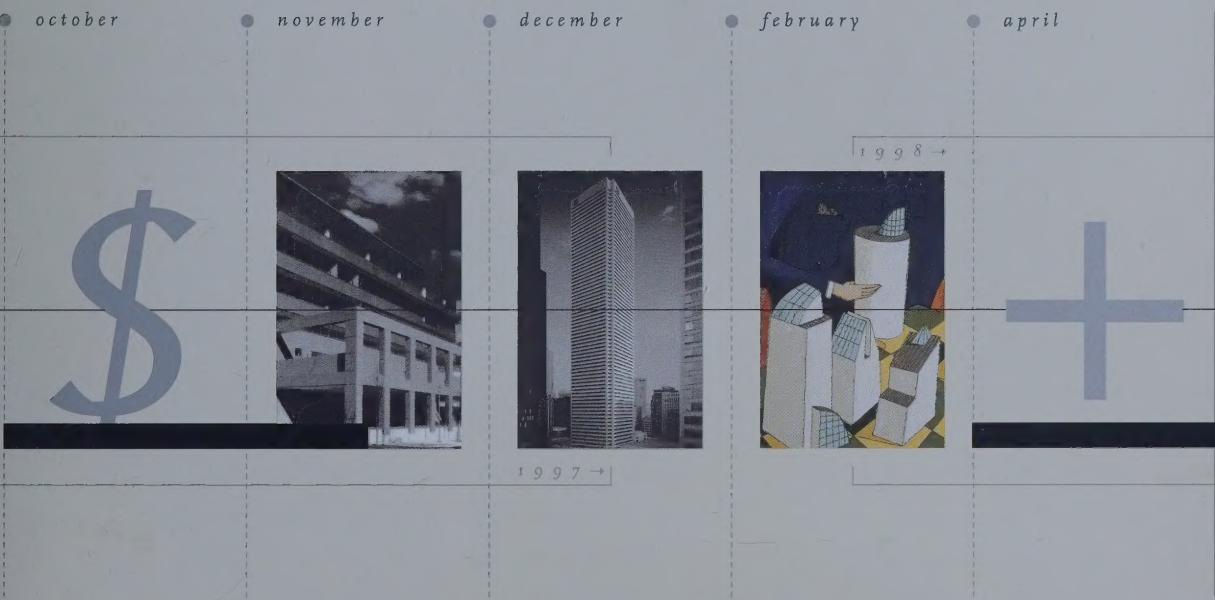
→ ACQUIRED A 51.25%  
INTEREST IN 5140 YONGE  
STREET IN THE NORTH  
YORK CIVIC CENTRE.

→ COMPLETED THE  
COMBINATION OF  
O&Y PROPERTIES AND  
CAMDEV CORPORATION.

→ LEASED 200,000  
SQUARE FEET AT  
5140 YONGE STREET TO  
TRIMARK INVESTMENT  
MANAGEMENT.

→ ACQUIRED THREE  
OFFICE BUILDINGS  
ALONG THE YONGE  
SUBWAY LINE IN  
TORONTO.

FROM FEBRUARY 1, 1997 TO APRIL 30, 1998, O&Y PROPERTIES INCREASED ITS INTERESTS IN OWNED PROPERTIES FROM 2.3 MILLION SQUARE FEET TO 7.6 MILLION SQUARE FEET INCLUDING THE PENDING ACQUISITION OF THE MERIT PORTFOLIO AND ALTIUS CENTRE. THE MANAGED PROPERTIES PORTFOLIO HAS GROWN TO 75 MILLION SQUARE FEET WITH THE PENDING ACQUISITION OF ENTERPRISE PROPERTY GROUP. WE LEASED A TOTAL OF 2.6 MILLION SQUARE FEET OF OFFICE, RETAIL AND INDUSTRIAL SPACE IN OUR OWNED AND MANAGED PROPERTIES.



- COMPLETED A \$55 MILLION EQUITY OFFERING AT \$8.00 PER SHARE.
- ACQUIRED THE 149,000 SQUARE FOOT "ACRES HOUSE" OFFICE BUILDING IN NIAGARA FALLS, ONTARIO.
- ACQUIRED AN INDIRECT 28% INTEREST IN I FIRST CANADIAN PLACE, AT THE CENTRE OF TORONTO'S FINANCIAL DISTRICT.
- LEASED 200,000 SQUARE FEET IN PLACE DE VILLE TO THE GOVERNMENT OF CANADA AND EXTENDED BY 5 YEARS (FROM 2003 TO 2008) THE TERM ON 650,000 SQUARE FEET ALREADY UNDER LEASE TO THE GOVERNMENT OF CANADA.
- AGREED TO ACQUIRE ENTERPRISE PROPERTY GROUP WITH 50 MILLION SQUARE FEET OF REAL ESTATE SERVICES CONTRACTS.
- AGREED TO ACQUIRE INTERESTS IN 1.3 MILLION SQUARE FEET IN WESTERN CANADA WITH THE ACQUISITION OF THE MERIT PORTFOLIO AND ALTIUS CENTRE.

"REAL ESTATE OPPORTUNITIES ABOUND IN ANY MARKET ENVIRONMENT – FOR THOSE COMPANIES WITH THE RESOURCES, IMAGINATION AND DRIVE TO SEIZE THEM, O&Y PROPERTIES IS SUCH A COMPANY."

# a blueprint FOR OPPORTUNITY

OUR STRATEGY IS FOCUSED ON ACQUIRING OFFICE PROPERTIES IN MAJOR MARKETS ACROSS CANADA AND AGGRESSIVELY GROWING OUR REAL ESTATE SERVICES BUSINESS. ON THE ACQUISITION SIDE, WE ARE UNIQUE IN THAT WE FOCUS ON A SINGLE SECTOR BUT IN A WIDE GEOGRAPHIC AREA. ON THE REAL ESTATE SERVICES SIDE, WE ARE FOCUSED ON BEING THE INDUSTRY LEADER IN SERVICE AND TECHNOLOGY.

→ In building our owned property portfolio, we rely upon our ability to read the market and anticipate emerging opportunities and trends. Our tightly focussed management team keeps a sharp eye on evolving market conditions and anticipates change by maintaining a balanced office property portfolio – one that offers rewards in a strong and growing domestic economy yet provides a hedge against downside risk. Attractive initial cash flows from major tenants and competitive advantages that have the potential to enhance rental and occupancy rates are features of properties that are often best-in-class and have a strong yield potential. → Our innovative approach to deal structuring and the use of equity as acquisition currency is a significant advantage for those property vendors who, for various reasons, prefer a private transaction to a “fully marketed deal.” O&Y Properties offers them a mix of “currencies” to conclude the transaction, including debt, cash and equity in our Company. This “securitization” of the vendors’ property portfolio allows them to benefit from future value growth and appreciation of their properties while allowing the Company to structure the acquisition on more favourable terms. In effect, we are helping vendors “turn bricks and mortar into liquid real estate” and obtaining better pricing as a result. → Finally, our recognized strengths in the real estate services field and aggressive expansion with the pending acquisition of Enterprise Property Group provides us an excellent platform from which to assess acquisition opportunities and to add value to our clients’ and owned properties.

RAGHUNATH DAVLOOR

Senior Vice-President

Investments





"READING THE MARKET, ENSURING A TIMELY DEAL FLOW, RESPONDING QUICKLY TO POTENTIAL OPPORTUNITIES AND STRUCTURING INNOVATIVE DEALS – THESE ARE THE ATTRIBUTES THAT DEFINE OUR SUCCESS IN THIS BUSINESS. THEY ARE OUR BLUEPRINT FOR FUTURE GROWTH."

# seizing OPPORTUNITY

DURING THE YEAR, ONS PROPERTIES CORPORATION CONCLUDED A NUMBER OF TRANSACTIONS THAT DEMONSTRATED OUR ABILITY TO SOURCE AND CONCLUDE OPPORTUNISTIC ACQUISITIONS IN BOTH "A" AND "B" CLASS OFFICE PROPERTIES.

Our acquisition of a 28% interest in First Place Tower Inc., which owns a significant interest in First Canadian Place in Toronto, builds on a 30-year history of involvement with this "trophy" property. At an implied value of \$288 per square foot on a freehold basis, the acquisition compares very favourably to other transactions last year in Toronto's financial core and has significant growth potential in the mid- to long-term. → Early last year we purchased a majority interest in 5140 Yonge Street, a 549,000 square foot, 23-storey building in Toronto. To be renamed the Trimark Tower, this Class "A" building is a perfect example of creating value by building on relationships and reputation in the leasing area. → Our first portfolio acquisition was three buildings located along Toronto's Yonge subway line. These Class "B+" buildings are located in Class "A" locations and allow us to take advantage of strong improvement in the commercial office market and the diminishing supply of Class "A" buildings in Canada's most heavily populated commercial corridor. We subsequently bought the six-storey, 149,000 square foot Acres House, the only Class "A" building in Niagara Falls, Ontario. → Our agreement to acquire a major portfolio in Western Canada from the Merit group will improve our geographic diversification outside of Ottawa and Toronto. The portfolio includes six office buildings in Calgary, including the McFarlane Tower with 238,000 square feet and the Franklin Atrium with 144,000 square feet of space, and two Winnipeg office buildings known as Royal Trust I and II, with combined space of 220,000 square feet. As part of the transaction, we also acquired just under one million square feet of real estate services assignments in Winnipeg. In a separate transaction, we also agreed to acquire a 50% interest in Altius Centre, a prominent 305,000 square foot building in Calgary.

JOHN LEVITT

*Senior Vice-President  
Business Development*





"THESE ACQUISITIONS DEMONSTRATE WHAT WE MEAN BY 'BUYING WELL'. WE INVEST IN QUALITY OFFICE BUILDINGS IN MAJOR COMMERCIAL CENTRES, IMPROVE THEIR VALUE EVEN FURTHER AND REALIZE ON PEAK VALUES. IT IS HOW WE BUILD ON OPPORTUNITY."

# managing OPPORTUNITY

O&Y PROPERTIES CORPORATION HAS A SOLID REPUTATION FOR ITS EFFICIENT OPERATIONS THAT MAINTAIN OPERATING COSTS BELOW THOSE OF COMPETING BUILDINGS. WE LEVERAGE THIS TRACK RECORD TO ATTRACT NEW REAL ESTATE SERVICES CLIENTS AND ADD VALUE TO OUR OWNED AND MANAGED PROPERTY PORTFOLIO.

With our agreement to purchase Enterprise Property Group, the Company will add 50 million square feet to our managed properties portfolio and be transformed into the dominant player in this market. The transaction reflects our aggressive growth strategy that capitalizes on the relationship opportunities between real estate ownership and service delivery. → It also underscores a trend towards consolidation in the Canadian real estate industry. The combination of O&Y Properties and Enterprise Property Group will result in Canada's largest commercial real estate services company. With a total of nearly 75 million square feet under management and 1,500 people from coast to coast, O&Y Enterprise will have the critical mass to lead the real estate services industry into the next millennium with state-of-the-art skills and technology. → Our management, through O&Y/SMG Canada, of the 1.3 million square foot National Trade Centre located on the grounds of Exhibition Place in Toronto is a success story that highlights the growing trend towards private management of public buildings. This new \$180 million centre is the third largest exhibition facility in North America. → We will continue to grow our real estate services business and the specialized skills required to service special client needs by obtaining new technology and talent through strategic partnerships based on the O&Y/SMG model, and by extending our services to existing clients.

GEOFF HARRISON

*Senior Vice-President*

*& Managing Director, Real Estate Services*





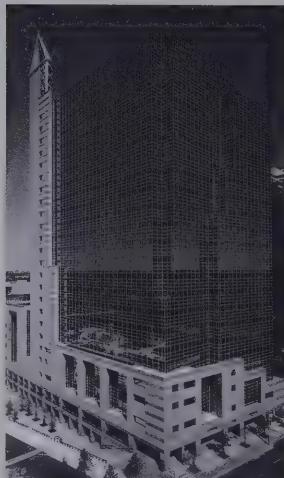
"THE MANAGEMENT AND OWNERSHIP SIDES OF OUR BUSINESS ARE DISTINCT YET COMPLEMENTARY. OUR  
RECOGNIZED STRENGTH AS REAL ESTATE MANAGERS, ALONG WITH OUR NETWORK OF BRANCH OFFICES  
ACROSS THE COUNTRY, PROVIDE A STRONG FOUNDATION FOR OUR OVERALL CORPORATE GROWTH STRATEGY."

# owned PROPERTIES

5140 Yonge Street  
Toronto, Ontario



Place de Ville I  
Ottawa, Ontario



5140 Yonge Street  
Toronto, Ontario



1 First Canadian Place  
Toronto, Ontario

| Property                                       | Date Developed/<br>Renovated | Approximate Gross<br>Leasable Areas ("GLA") (sq. ft.) |                          |         | Leased or<br>Committed | %   | %   | GLA     | Interest of<br>the Corporation(1) | Major Tenant |
|--|------------------------------|---|--------------------------|---------|------------------------|-----|-----|---------|-----------------------------------|--------------|
|  |                              | Office<br>Area  | Retail &<br>Storage Area | Total   |                        |     |     |         |                                   |              |
| Place de Ville I<br>(Ottawa, Ontario)          | 1967/<br>1986-89             | 548,000   | 66,000                   | 614,000 | 97                     | 100 | 100 | 614,000 | Government of Canada              |              |
| Place de Ville II<br>(Ottawa, Ontario)         | 1972/<br>1995                | 579,000   | 100,000                  | 679,000 | 94                     | 100 | 100 | 679,000 | Government of Canada              |              |
| Jean Edmonds Towers<br>(Ottawa, Ontario)       | 1973/<br>1995                | 531,000   | 116,000                  | 647,000 | 99                     | 100 | 100 | 647,000 | Government of Canada              |              |
| Pinecrest Office Building<br>(Ottawa, Ontario) | 1985/<br>1993                | 79,000  | —                        | 79,000  | 100                    | 100 | 100 | 79,000  | Government of Canada              |              |
| Kanata Town Centre Mall<br>(Kanata, Ontario)   | 1982/<br>1992                | 18,000  | 87,000                   | 105,000 | 80                     | 100 | 100 | 105,000 | Food Basics                       |              |
| 21 Richardson Side Road<br>(Kanata, Ontario)   | 1984                         | 49,000  | —                        | 49,000  | 100                    | 100 | 100 | 49,000  | Nortel                            |              |
| 1-9 Brewer Hunt Way<br>(Kanata, Ontario)       | 1984                         | 47,000  | —                        | 47,000  | 100                    | 100 | 100 | 47,000  | Nortel                            |              |
| 2625 Queensview Drive<br>(Ottawa, Ontario)     | 1983                         | 46,000  | —                        | 46,000  | 100                    | 100 | 100 | 46,000  | SHL Systemhouse                   |              |
| Pinecrest Retail Building<br>(Ottawa, Ontario) | June<br>1997                 | —   | 43,000                   | 43,000  | 100                    | 100 | 100 | 43,000  | Chapters                          |              |
| 10 Brewer Hunt Way<br>(Kanata, Ontario)        | 1970/<br>1984                | 28,000  | —                        | 28,000  | 52                     | 100 | 100 | 28,000  | Lockheed Martin Canada            |              |

2/24 St. Clair Avenue West  
Toronto, Ontario



18 King Street East  
Toronto, Ontario



Acres House  
Niagara Falls, Ontario

| Property   | Date Developed/<br>Renovated | Approximate Gross<br>Leasable Areas ("GLA") (sq. ft.) |                          |           | Leased or<br>Committed |       | Interest of<br>the Corporation(1) |                               | Major Tenant |
|--|------------------------------|---|--------------------------|-----------|------------------------|-------|-----------------------------------|-------------------------------|--------------|
|  |                              | Office<br>Area  | Retail &<br>Storage Area | Total     | %                      | %     | GLA                               |                               |              |
| 1 First Canadian Place<br>(Toronto, Ontario)     | 1975                         | 2,223,000   | 453,000                  | 2,676,000 | 96                     | 27.98 | 749,000                           | Bank of Montreal              |              |
| 5140 Yonge Street<br>(Toronto, Ontario)(2)       | 1987                         | 532,000   | 17,000                   | 549,000   | 98                     | 51.25 | 281,000                           | Trimark Investment Management |              |
| 18 King Street East<br>(Toronto, Ontario)        | 1967-68/<br>1989             | 218,000   | 15,000                   | 233,000   | 83                     | 100   | 233,000                           | Unum Life Insurance           |              |
| 2/24 St. Clair Avenue West<br>(Toronto, Ontario) | 1965/<br>1989                | 209,000   | 29,000                   | 238,000   | 86                     | 100   | 238,000                           | Standard Broadcastir          |              |
| 40 St. Clair Avenue West<br>(Toronto, Ontario)   | 1966/<br>1989                | 118,000   | 9,000                    | 127,000   | 98                     | 100   | 127,000                           | Government of Onta.           |              |
| Acres House<br>(Niagara Falls, Ontario)          | 1995                         | 149,000   | -                        | 149,000   | 89                     | 100   | 149,000                           | Acres International           |              |
| Total (Ottawa & Toronto)                         |                              | 5,374,000   | 935,000                  | 6,309,000 | 95                     |       | 4,114,000                         |                               |              |

Notes:

(1) All of these assets are held in freehold, except for Place de Ville I (which is leased until 2065); 1 First Canadian Place (in respect of which the Corporation owns an indirect 27.98% interest in First Place Tower Inc., which owns a 50% freehold and a 50% leasehold interest in the land and a 100% ownership interest in the building comprising 1 First Canadian Place); 5140 Yonge Street (in respect of which the Corporation owns a 51.25% interest in a promissory note secured by a leasehold mortgage of 5140 Yonge Street and related security, the lease of which expires in 2083); and 18 King Street East (which is leased until 2067).

(2) Assumes the conversion of the interest held in the promissory note secured by this property into a leasehold ownership interest.

H&Y

PORTFOLIO

# Properties

Corporation

# managed PROPERTIES

National Trade Centre  
Toronto, Ontario



Scotia Plaza  
Toronto, Ontario



National Trade Centre  
Toronto, Ontario



First Canadian Centre  
Calgary, Alberta

| Property                         | Type             | Location          | Size (sq. ft.) | Major Tenant          |
|----------------------------------|------------------|-------------------|----------------|-----------------------|
| Scotia Plaza                     | Office/Retail    | Toronto, Ontario  | 1,598,000      | Bank of Nova Scotia   |
| Canteen & ST Complex             | Office           | Toronto, Ontario  | 705,000        | Rogers Communications |
| Lawrence Square                  | Retail/Office    | Toronto, Ontario  | 692,000        | Zellers               |
| National Trade Centre            | Public Facility  | Toronto, Ontario  | 1,339,000      | National Trade Centre |
| Ancaster Entertainment Centre    | Retail           | Ancaster, Ontario | 128,000        | Famous Players        |
| St. Clair Beach Shopping Centre  | Retail           | Windsor, Ontario  | 79,000         | Zehr's                |
| First Canadian Centre            | Office           | Calgary, Alberta  | 525,000        | Bank of Montreal      |
| Glenmore Landing Shopping Centre | Retail           | Calgary, Alberta  | 147,000        | Safeway               |
| Brentwood Office Centre          | Office/Warehouse | Burnaby, B.C.     | 197,000        | Government of Canada  |

Glenmore Landing  
Calgary, Alberta



Ancaster Entertainment Centre  
Ancaster, Ontario



*First Canadian Place  
Shopping Centre  
Toronto, Ontario*

| Combined Portfolio | BC        |    |     | Western Region |     |      | Ontario    |     |      | Quebec    |     |      | Maritimes |    |     |
|--------------------|-----------|----|-----|----------------|-----|------|------------|-----|------|-----------|-----|------|-----------|----|-----|
|                    | (sq. ft.) | #  | %   | (sq. ft.)      | #   | %    | (sq. ft.)  | #   | %    | (sq. ft.) | #   | %    | (sq. ft.) | #  | %   |
| Office             | 1,106,000 | 15 | 1.4 | 5,441,000      | 50  | 7.2  | 17,499,000 | 81  | 23.1 | 2,755,000 | 37  | 3.7  | 1,175,000 | 15 | 1.6 |
| Retail             | 730,000   | 10 | 1.0 | 6,048,000      | 74  | 8.0  | 13,015,000 | 140 | 17.1 | 4,645,000 | 51  | 6.1  | 2,146,000 | 20 | 2.8 |
| Industrial         | 1,515,000 | 11 | 2.0 | 4,935,000      | 63  | 6.5  | 2,459,000  | 31  | 3.2  | 2,284,000 | 24  | 3.0  | 933,000   | 12 | 1.2 |
| Residential        | 48,000    | 4  | 0.1 | 5,172,000      | 74  | 6.8  | 656,000    | 5   | 0.9  | 151,000   | 1   | 0.2  | 238,000   | 2  | 0.3 |
| Other              | 410,000   | 1  | 0.5 | 1,135,000      | 10  | 1.5  | 1,339,000  | 1   | 1.8  | -         | -   | -    | -         | -  | -   |
| Total              | 3,809,000 | 41 | 5.0 | 22,731,000     | 271 | 30.0 | 34,968,000 | 258 | 46.1 | 9,835,000 | 113 | 13.0 | 4,492,000 | 49 | 5.9 |

| Combined Portfolio | Total for all Regions (sq. ft.) | Total # | Total % |
|--------------------|---------------------------------|---------|---------|
| Office             | 27,976,000                      | 198     | 37      |
| Retail             | 26,584,000                      | 295     | 35      |
| Industrial         | 12,126,000                      | 141     | 16      |
| Residential        | 6,265,000                       | 86      | 8       |
| Other              | 2,884,000                       | 12      | 4       |
| Total              | 75,835,000                      | 732     | 100     |



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*For the year ended January 31, 1998*

### OVERVIEW

O&Y Properties Corporation has achieved a significant transformation since its last annual report to shareholders. In the discussion that follows, we review the transactions completed in the past year and comment on their impact. We also report on the results of operations for the last fiscal year, analyse the Company's capital structure and discuss our expectations looking forward.

In December 1996, an investor group known as RHII Limited Partnership and led by Philip Reichmann and Frank Hauer acquired a majority interest in Camdev Corporation. Shortly thereafter, Philip Reichmann and Frank Hauer became Chief Executive Officer and President, respectively, and at its annual general meeting held on July 30, 1997, the Company's shareholders approved a change of name to O&Y Properties Corporation.

One of management's primary goals is to establish the Company as a real estate ownership and services organization of sufficient size to access public capital markets and compete effectively and efficiently in the Canadian real estate sector.

Over the past year, the Company moved aggressively to take advantage of the strengthening real estate market by acquiring interests in commercial real estate and expanding its property management business. OYPC has completed a number of property acquisitions to significantly increase its asset base, while at the same time ensuring an appropriate capitalization of the Company. Moreover, upon the completion of its recently announced acquisition of Enterprise Property Group, OYPC will be Canada's largest commercial real estate services company and well positioned to continue its growth.

In the coming year, we will focus on continuing to achieve growth through:

- Acquiring income producing office and mixed used properties that are accretive to earnings and cash flow;
- Repositioning existing assets through capital upgrades in order to maintain and create additional value;
- Sourcing development opportunities in order to take advantage of improving markets; and
- Utilizing both private placement and public market financing, with the aim of increasing the liquidity of our stock while maintaining conservative leverage.

Growth will continue to be more broadly focussed geographically in order to diminish our reliance on the Ottawa market where we are now effectively fully leased. Our acquisition targets will remain office buildings, which we consider our core competency, and will centre on Class "A" and "B" buildings with upside potential.

### *Property Ownership*

At January 31, 1998, OYPC's portfolio of owned properties consisted of 6.3 million square feet of commercial mixed-use income properties of which OYPC's owned interest was 4.1 million square feet. Since then, the Company has contracted to acquire properties that will increase the portfolio size to 7.6 million square feet, with the Company's owned interest totaling 5.3 million square feet.

OYPC currently has one significant development site located at the northeast corner of Queen and Yonge Streets in Toronto. The 2 Queen Street East site has the potential for the development of a 350,000 square foot office tower, incorporating the historic facade of a former bank branch. The site is one of only a few that are 'development ready' in Toronto's financial district. We intend to begin the predevelopment of this site and to lever our market knowledge into other development opportunities.

The Company's owned properties are located primarily in the Toronto and Ottawa areas. Since its fiscal year end, the Company has entered into agreements to acquire interests in nine more office buildings in Calgary and Winnipeg.

The composition of the Company's interest in properties by geographic region is as follows:

| January 31<br>(in thousands) | Proforma (1) 1998 |     | 1998    |     | 1997    |     |
|------------------------------|-------------------|-----|---------|-----|---------|-----|
|                              | Sq. Ft.           | %   | Sq. Ft. | %   | Sq. Ft. | %   |
| Ottawa Area                  | 2,337             | 44  | 2,337   | 57  | 2,294   | 100 |
| Toronto Area                 | 1,777             | 33  | 1,777   | 43  | —       | —   |
| Western Canada               | 1,196             | 23  | —       | —   | —       | —   |
|                              | 5,310             | 100 | 4,114   | 100 | 2,294   | 100 |

(1) After acquisition of Western Canada properties.

#### Real Estate Services

The Company provides a full range of real estate services to third parties, including property management, leasing, design, redevelopment and construction management. Properties under management range from prestigious mixed-use developments and high-rise office towers to community retail centres and industrial parks located across Canada. The combination of real estate services and ownership will continue to lead to benefits and synergies including access to market knowledge and better resource utilization. In addition to stable management fee income, the real estate services business involves relationships with many other owners of real estate across Canada. These relationships are a source of business development opportunity for the Company, both in the real estate services business and in its acquisition and ownership segment.

#### FISCAL 1998 TRANSACTIONS

##### O&Y Properties Inc.

Following the acquisition of O&Y Properties Inc. in May 1997, the Company combined its property operations for owned properties with those of the real estate services group. Accounting, human resources, information systems and other support functions have since been integrated.

Of the \$15 million paid for O&Y Properties Inc., \$12.6 million was attributed to the real estate services contracts and the balance to working capital items. Based on eight months of operating performance, the acquisition of the real estate services contract portfolio, including synergies, has generated a yield of 17% (defined as annualized operating cash flow before debt service as a percentage of the investment).

##### 5140 Yonge Street

During the year, the Company acquired an effective 51.25% interest in 5140 Yonge Street, a 549,000 square foot Class "A" office building located in Toronto. The Company's interest in the property is held through a 51.25% interest in a promissory note secured by a leasehold mortgage of the building (the "5140 Interest") and was acquired on May 29, 1997 for consideration of \$21.2 million. The acquisition of the 5140 Interest was made in anticipation of Petro-Canada, a major tenant, vacating approximately 180,000 square feet of space upon expiry of its lease on June 30, 1997.

The promissory noteholders, including the Company, went into possession and commenced foreclosure proceedings to convert their interest in the note into a direct leasehold interest in the underlying income-producing property. Subsequent to year end, there was an attempt to convert the proceedings into a judicial sale that could result in a disposition of the property. The Company has resisted these actions. In the event of a judicial sale to other than the Company, a gain of approximately \$19 million on its original \$21 million investment would result.

The yield on the 5140 Interest was 9% on acquisition including the operating costs relating to the vacant Petro-Canada space. Subsequent to the acquisition of the 5140 Interest, the Company concluded a lease for virtually all of the vacant space in the building with Trimark Investment Management Inc. The yield on the 5140 Interest, after taking into account the Trimark lease, is expected to increase from 9% to 13%.

#### *Toronto Office Building Portfolio*

In September 1997, the Company acquired a portfolio of three office buildings totaling 598,000 square feet located in downtown Toronto, each in close proximity to the Yonge Street subway line. The buildings are located at 18 King Street East, 2 and 24 St. Clair Avenue West and 40 St. Clair Avenue West.

The Company acquired the portfolio from private vendors for \$81 million or \$135 per square foot, with the expectation of benefiting from the declining availability of office space in the Toronto central business district, particularly the financial district. As net effective rents in the financial district approach \$30 per square foot in Class "A" buildings, the Company believes there will be increased demand for lower cost Class "B" space.

This portfolio was acquired at an initial yield of 8.3%. This yield reflects a vacancy rate in the portfolio of 12% or approximately 70,000 square feet. The Company's plan is to lease this vacant space into the strengthening market over a reasonable period of time. Plans also include the expenditure of approximately \$4 million for architectural modernization and mechanical upgrades that are designed to further enhance the attractiveness and competitiveness of the buildings in their market. Contracted office rents in place average \$15 net per square foot, which are at present higher than market, but only 27% of the contracted office rents in place are subject to renewal or expiry over the next three years. The combination of available vacant space for lease, revenue from above market rent in the short-term and the potential to renew these leases in a rising market are expected to provide the Company with an opportunity to generate a superior return.

At the time of acquisition, the portfolio carried \$22.5 million of first mortgage financing. Subsequent to the end of the fiscal year, two of the buildings were refinanced, increasing the total leverage to \$40 million. Following the completion of the leasing and repositioning programs, the leverage is expected to be further increased.

#### *Acres Building*

The Acres Building is a 149,000 square foot office building located in Niagara Falls, Ontario. The building was completed by its previous owner in 1996 at a cost in excess of \$20 million and acquired by the Company for \$6.35 million (\$43 per square foot). The building is 85% leased to tenants that provide services in hydroelectric consulting engineering and casino management. The yield from the property on acquisition was 11%.

The Company believes that Niagara Falls offers the opportunity to participate in a market that is in the early stages of development and will benefit from the growth of the gaming and tourism industries.

#### *First Canadian Place*

On December 16, 1997, the Company entered into a binding agreement to acquire all of the shares of a holding company that owns a 28% interest in First Place Tower Inc. ("FPTI"), a single-purpose company that holds a 50% freehold and 50% leasehold interest in the land and a 100% ownership interest in the building comprising 1 First Canadian Place. 1 First Canadian Place, which is managed by the Company, is the tallest office building in Canada. It is a 72-storey, 2.7 million square foot premier office and mixed-use complex at the corner of King and Bay Streets in the centre of Toronto's financial district.

The consideration for the purchase consisted of \$29 million in cash and \$32 million by the issuance of 3,365,881 common shares of the Company at \$9.63 per share. The acquisition price for the Company's interest in the property equates to an implied value of approximately \$182 per square foot on a leasehold basis. If calculated on a freehold basis, this would equate to an implied value of approximately \$288 per square foot.

The Company's investment in FPTI was acquired at an initial yield of approximately 9.5%. FPTI's debt includes \$143 million of 9.22% first mortgage bonds due in 2005 and 8.5% convertible debentures due in 2015. FPTI is currently examining certain refinancing options which would result in the redemption of the bonds and the debentures. This initiative would be expected to increase the Company's yield after debt service.

#### *The National Capital Region Portfolio*

The Company's portfolio of five office towers in Ottawa represent nearly two million square feet of the Company's overall office portfolio. These properties are the platform from which the Company was able to build its portfolio significantly in the past year.

At the beginning of the year, approximately 65% of the Company's downtown Ottawa portfolio was subject to lease renewal in the years 2003 and 2004. Approximately half of this amount, or 650,000 square feet, was subject to a federal government lease which called for a rent reset to take effect November 1, 1998. In November 1997, the federal government and the Company reached an agreement to reset the rent to the equivalent of \$16 net per square foot for five years to 2003, and to extend the term for a further five years to 2008 at the equivalent of \$9 net per square foot. In Place de Ville I, the Company had accumulated an inventory of 200,000 square feet of space either vacant or subject to short-term leases, in anticipation of a significant leasing transaction. In connection with these negotiations, the Company leased the 200,000 square feet of accumulated space in Place de Ville I until 2008 at the equivalent of \$10 net per square foot.

Both agreements are scheduled to take effect November 1, 1998. As a result, rental income will be unchanged once other incidental vacant space in the complex has been leased. The shift of lease maturity concentration in 2003 and 2004 was a key objective for the Company during these negotiations. Co-incident with the reset of the Place de Ville II rent and pursuant to the terms of the \$110 million Series A and B bonds, annual debt service will be reduced by \$3 million.

#### *Lease Expiry Profile*

After giving effect to these transactions, the following table indicates, as at January 31, 1998, the yearly total of office space subject to lease expiry over the next five fiscal years (assuming tenants do not exercise renewal options), the percentage of total gross leaseable area represented by such expiries and the average net rental rates per square foot at the time of expiry. The table includes the Company's proportionate interest in 5140 Yonge Street and 1 First Canadian Place.

| year | Ottawa Area |          |                         | Toronto Area |          |                         |
|------|-------------|----------|-------------------------|--------------|----------|-------------------------|
|      | Sq. ft      | % of GLA | Avg. net<br>rent p.s.f. | Sq. ft       | % of GLA | Avg. net<br>rent p.s.f. |
| 1999 | 37,901      | 2.2      | \$ 11.01                | 126,589      | 8.7      | \$ 23.90                |
| 2000 | 134,823     | 7.7      | \$ 12.66                | 50,944       | 3.5      | \$ 12.11                |
| 2001 | 48,847      | 2.8      | \$ 17.47                | 82,630       | 5.7      | \$ 14.57                |
| 2002 | 15,847      | 0.9      | \$ 11.62                | 88,564       | 6.1      | \$ 15.80                |
| 2003 | 21,371      | 1.2      | \$ 10.57                | 249,294      | 17.1     | \$ 16.31                |

#### ACQUISITIONS AFTER THE FISCAL YEAR END

##### *Enterprise Property Group*

On April 14, 1998, the Company entered into an agreement to acquire privately owned Enterprise Property Group, one of Canada's largest real estate services companies. Added to its existing business, the Enterprise portfolio of 50 million square feet of commercial, industrial and residential real estate services contracts will transform the Company into Canada's largest commercial real estate services company with over 75 million square feet under management. Enterprise was the recipient of the Financial Post Canada's 50 Best Managed Private Companies Award.

The purchase price of \$18 million will be satisfied through the payment of \$9.25 million cash and approximately 897,000 common shares issued at \$9.75 per share. The agreement includes additional performance-based consideration designed to increase the purchase price by up to \$6 million through the issue of additional shares if certain financial performance thresholds are met.

#### *Western Canada Properties*

Subsequent to the fiscal year end, the Company announced its intention to acquire, in two separate transactions, interests in nine office properties located in Western Canada. The closing of the two transactions is expected during the second quarter of the current fiscal year.

The larger transaction (the "Merit Portfolio"), a 1 million square foot portfolio of office properties located in Calgary and Winnipeg, is contracted to be acquired for \$96 million, and includes a small portfolio of real estate services contracts and a downtown Winnipeg development site. The expected consideration is \$14 million of cash, \$60 million of debt financing and \$22 million through the issuance of 2,505,774 common shares of the Company.

The Merit Portfolio includes six Class "B" office buildings in Calgary totaling 822,000 square feet. The going in unlevered yield on these properties is 7%; the properties have average rents in place of \$6 net per square foot and are 88% occupied. A significant proportion of the leases in these buildings are at rates below current market levels and are due to expire within the next 24 to 36 months. The following table indicates the yearly total square footage subject to lease expiry over the next five fiscal years.

|                          | Sq. Ft. | % of GLA | Avg. net rent p.s.f. |
|--------------------------|---------|----------|----------------------|
| 1999 (from June 1, 1998) | 61,032  | 7.4      | \$ 5.12              |
| 2000                     | 83,466  | 10.2     | \$ 4.84              |
| 2001                     | 109,451 | 13.2     | \$ 4.98              |
| 2002                     | 190,140 | 23.1     | \$ 5.70              |
| 2003                     | 136,257 | 16.6     | \$ 7.01              |

The Winnipeg properties included in the Merit Portfolio consist of two buildings totaling 222,000 square feet. The going in unlevered yield on these properties is 13%. The properties have average net rents of \$11 in place and are 91.6% occupied. The Winnipeg properties provide a foothold into a new market for the Company, with strong initial returns in a stable and improving market. The following table indicates the yearly total square footage subject to lease expiry over the next five fiscal years.

|                          | Sq. Ft. | % of GLA | Avg. net rent p.s.f. |
|--------------------------|---------|----------|----------------------|
| 1999 (from June 1, 1998) | 33,875  | 15.3     | \$ 9.92              |
| 2000                     | 16,420  | 7.4      | \$ 11.64             |
| 2001                     | 70,030  | 31.5     | \$ 11.23             |
| 2002                     | 3,028   | 1.4      | \$ 8.00              |
| 2003                     | 36,031  | 16.2     | \$ 9.61              |

The second transaction (the "Altius Centre") involves the acquisition of a 50% interest in a prominent 305,000 square foot Calgary office tower, for expected cash consideration of \$10 million plus debt financing of \$17.5 million for the Company's interest. The other participant in this joint venture is Grosvenor International Canada Limited, a Vancouver-based real estate company.

The Altius Centre offers a significant opportunity to re-lease space into a rising market. The Company's going in unlevered yield is 6.5% based on average rents in place of \$10 net per square foot. Recent offers to lease have been negotiated in the \$20 per square foot range, net effective. With Calgary vacancy reported at approximately 3%, the property is positioned to take advantage of the current supply imbalance, which is expected to last several more years. The following table indicates the yearly total square footage subject to lease expiry over the next five fiscal years:

|                          | Sq. Ft. | % of GLA | Avg. net rent p.s.f. |
|--------------------------|---------|----------|----------------------|
| 1999 (from June 1, 1998) | 68,327  | 22.4     | \$ 9.77              |
| 2000                     | 59,751  | 19.6     | 8.26                 |
| 2001                     | 15,982  | 5.3      | 11.26                |
| 2002                     | 55,592  | 18.3     | 8.93                 |
| 2003                     | 90,814  | 29.8     | 12.36                |

Overall, the Company believes that these acquisitions provide an opportunity to create value through management efficiencies and implementation of repositioning strategies which will minimize rollover vacancies and allow the Company to maximize rental rates.

#### ASSET DISPOSITIONS

The Company's strategy includes periodic review of its holdings to determine when an asset has reached its full potential and capital can be better deployed elsewhere.

During the year, the Company disposed of two non-core development sites in Kanata, Ontario, one a 180 acre unserviced site for \$8.8 million and another 45 acre site for \$1.5 million.

The Citadel Hotel, which forms part of the Place de Ville I complex, was sold April 2, 1998 for \$19.8 million. Owning hotels is not a focus of the Company. The sale of the property in the present strong hotel investment market results in an increase in cash flow from operations, as the reduction in net revenue as a result of the sale is more than offset by reduced financing and ground rent expenses.

#### RESULTS OF OPERATIONS

Net income for the year ended January 31, 1998 was \$18.3 million, or \$0.60 per share, compared to \$12.0 million, or \$0.49 per share, for the year ended January 31, 1997. Of the \$6.3 million increase over the prior year, approximately \$3.9 million relates to income from properties acquired during the year. Gains on the disposition of two Kanata land parcels compared to similar gains in the prior year and reduced financing costs account for the remaining increase.

Revenues from office and mixed-use properties increased by \$12.3 million to \$64.9 million for the year ended January 31, 1998. The acquisition of rental properties in the year resulted in an increase in revenues of \$13.4 million, offset by a decrease which was primarily the result of the accumulation of an inventory of formerly vacant space in Ottawa.

Hotel and shopping centre revenue decreased by \$8.8 million to \$2.3 million. The sale of Galleria London shopping centre in July 1996 and the sale of the Radisson hotel property in Place de Ville II in November 1996 accounted for the decrease.

Both of these properties, a part of the Company's hotel and shopping centre segment, were considered to be non-core income properties. The last remaining property in this segment, the Citadel Hotel in downtown Ottawa, was sold on April 1, 1998 for a gain of approximately \$10.6 million, which will be recorded in the year ending January 31, 1999.

Revenues from real estate services increased by \$13.3 million to \$17.4 million for the year ended January 31, 1998. The acquisition of O&Y Properties Inc.'s real estate services operations resulted in an increase in revenues of \$11.9 million. The remaining net increase of \$1.4 million was primarily a result of increased tenant construction activity.

Rental income, which is rental revenue net of rental property operating expenses and realty taxes, increased by \$4.2 million to \$32.9 million in the office and mixed-use segment for the year ended January 31, 1998. The acquisition of rental properties during fiscal 1998 resulted in an increase in rental income of \$6.0 million. The remaining net decrease in rental income of \$1.8 million resulted primarily from the accumulation of vacant space in Ottawa and increased spending on building upgrades.

Rental income in the hotel and shopping centre segment decreased by \$3.2 million to \$1.5 million primarily due to the Galleria London shopping centre and Place de Ville II hotel property sales.

Real estate services income, which is revenue less expenses related thereto, increased by \$0.9 million to \$1.5 million for the year ended January 31, 1998. This increase was due to the acquisition and integration of O&Y Properties Inc.'s real estate services operations.

Financing expense decreased \$4.8 million to \$12.8 million for the year ended January 31, 1998. In March 1997, \$90.4 million of bridge financing bearing interest at floating rates was refinanced through an issue of \$110 million of first mortgage bonds. \$100 million of the first mortgage bonds bear interest at 6.5% and the remaining \$10 million bear interest at 10.69%. This refinancing resulted in a net decrease in financing expense of \$2.0 million. Proceeds from asset dispositions, applied to reduce debt, resulted in a further decrease in financing expense of \$2.6 million. New debt on acquisitions of rental properties in the recently completed fiscal year resulted in an increase in financing expense of \$1.5 million. As well, historically low interest rates reduced the borrowing cost on floating rate debt, and surplus cash generated interest income, resulting in a further decrease in financing expense of \$1.7 million.

Depreciation and amortization increased \$1.7 million to \$4.8 million for the year ended January 31, 1998, primarily as a result of amortization of real estate services contracts acquired as part of the O&Y Properties Inc. purchase.

The Company incurred large corporations and corporate minimum tax of approximately \$1.2 million in the year ended January 31, 1998, compared to approximately \$0.6 million in the year ended January 31, 1997. In addition, the Company's income is subject to income tax at statutory rates, which has been offset by the utilization of losses from prior years. The benefit of approximately \$31 million of tax losses has not been recorded in the financial statements and will be recognized when realized.

The following table highlights the growth in revenue, net income and cash flow from operations achieved in each quarter of the past fiscal year.

| <i>Three months ended (in thousands of dollars)</i> | <i>Revenue</i> | <i>Net income</i> | <i>Cash flow</i> |
|---|----------------|-------------------|------------------|
| April 30, 1997                                      | \$ 14,215      | \$ 3,024          | \$ 3,780         |
| July 31, 1997                                       | 19,522         | 6,953 (1)         | 4,550            |
| October 31, 1997                                    | 22,000         | 3,012             | 4,945            |
| January 31, 1998                                    | 28,835         | 5,321             | 6,661            |
| Twelve months ended                                 |                |                   |                  |
| January 31, 1998                                    | \$ 84,572      | \$ 18,310         | \$ 19,936        |

(1) Includes gain on disposal of \$3.8 million

#### ASSETS

Rental properties at January 31, 1998 were carried at \$490.9 million compared to \$241.8 million a year earlier. The increase of \$249.1 million is primarily a result of acquisitions of rental properties in the year. These acquisitions, described above, include a 28% interest in 1 First Canadian Place, a 51.25% interest in 5140 Yonge Street, three office buildings in Toronto and an office building in downtown Niagara Falls.

During the year, the development of the Pinecrest retail facility was completed at a total cost of \$4.2 million and was transferred from properties under development to rental properties. At January 31, 1998, there were no properties under development.

Land held for sale or development at January 31, 1998 totaled \$8.4 million compared to \$13.9 million a year earlier. During the year, the Company disposed of two Kanata land parcels for total proceeds of \$10.3 million. These sales resulted in a net gain of approximately \$3.5 million. At January 31, 1998, land held for sale or development consisted primarily of the site at the northeast corner of Queen and Yonge Streets in Toronto.

Real estate services contracts at January 31, 1998, net of amortization, were carried at \$11.6 million. These contracts were the principal asset of O&Y Properties Inc. when it was acquired during the year.

Accounts receivable at January 31, 1998 were \$8.8 million compared to \$3.0 million a year earlier. This \$5.8 million increase is primarily the result of acquisitions made by the Company in the year.

Other assets and deferred costs at January 31, 1998 were \$2.5 million compared to \$0.7 million a year earlier, with the increase attributable to financing costs incurred in the year.

#### CAPITAL STRUCTURE

During the year ended January 31, 1998, debt increased to \$264.0 million from \$151.5 million.

The Company issued \$110 million of fixed rate first mortgage bonds, secured by the Place de Ville II and Jean Edmonds Towers office complexes, maturing on December 31, 2004. \$100 million of this debt is fully amortized over the term of the loan and bears interest at 6.5%, compounded semi-annually. \$10 million of bonds accrue interest at 10.69%, compounded semi-annually, and will have a final maturity value of approximately \$22.6 million. \$90.4 million of the proceeds from the bond financing were used to retire a bridge loan.

Debt was further increased by \$76.1 million on the acquisition of the Company's interest in First Place Tower Inc. This debt comprised a bank loan of \$36.1 million and the Company's 28% proportionate share of \$143 million of First Place Tower Inc.'s first mortgage bonds. These bonds are due in 2005 and bear interest at 9.22%, compounded semi-annually.

Other acquisitions and financings accounted for an increase in debt of \$33 million. Regularly scheduled principal payments of \$16.2 million accounted for the remaining decrease.

Annual debt instalment payments range from \$13.9 million to \$16.8 million over the next five years. Debt balances due at maturity are as follows: \$13.7 million in 1999, \$58.6 million in 2000, \$35.0 million in 2001, \$7.5 million in 2003 and \$50.5 million after 2003.

During the year, a subsidiary of the Company issued \$7.6 million of non-dividend bearing preferred shares, \$6 million of which are redeemable on September 25, 1998, with the remaining \$1.6 million redeemable on September 25, 2001.

As well during the year, the Company issued \$15 million of 4.44% Series 1 preferred shares (the "Preferred Shares"). The Preferred Shares are redeemable on September 25, 2007, convertible into common shares of the Company at \$8.25 at the option of the holder, and redeemable under certain conditions at the option of the Company after September 25, 2002 (or after September 25, 2000 if the market price of the Company's common shares exceeds \$10.31) in cash or common shares. A subsidiary of the Company also issued \$13 million of 6% notes (the "Notes") which are exchangeable into 6% convertible debentures or common shares of the Company. The Notes are redeemable and convertible on substantially the same terms as the Preferred Shares.

During the year ended January 31, 1998, the Company raised \$118.8 million through the issuance of equity, increasing common shares outstanding to \$215.0 million at January 31, 1998 from \$96.2 million a year earlier.

At January 31, 1998, approximately 65% of the total secured debt bore interest at fixed rates with a weighted average rate of 7.47%. Floating rate debt was \$91.4 million and is generally based on Canadian chartered bank prime lending rates plus a spread. After completion of transactions which are scheduled to close in the second quarter of the current fiscal year, floating rate debt will be approximately \$109 million or 32% of total debt. Steps are being taken to hedge approximately \$75 million of floating rate debt with interest rate caps or swaps. The remaining \$34 million of unhedged floating rate debt will, for the most part, be repaid from the proceeds of long-term, fixed rate loans.

| As at January 31 (in millions of dollars)                            | <i>Proforma (1)</i> |            |            |
|--|---------------------|------------|------------|
|  | 1998                | 1998       | 1997       |
| Debt at fixed rates (including liability                             |                     |            |            |
| component of preferred shares and notes)                             | \$ 231,320          | \$ 190,120 | \$ 12,962  |
| Debt at floating rates   | 109,359             | 91,359     | 138,497    |
|  | <hr/>               | <hr/>      | <hr/>      |
|  | \$ 340,679          | \$ 281,479 | \$ 151,459 |
| Equity (including equity component of<br>preferred shares and notes) | \$ 311,204          | \$ 263,207 | \$ 108,209 |
| Debt to equity ratio   | 1.09:1              | 1.07:1     | 1:40:1     |

(1) After acquisition of Enterprise Property Group, the Merit Portfolio, Altius Centre and the sale of the Citadel Hotel.

The Company is committed to a capitalization consistent with the nature of its asset base. For example, the Ottawa properties that are subject to long-term federal government leases are financed with debt that amortizes over the term of the leases. As a result, at maturity, 1.1 million square feet of office space will have approximately \$20 per square foot of debt to be repaid or refinanced.

For properties that have been recently acquired and have a strong cash flow from quality tenants, and where a sufficient amount of long-term, fixed rate debt is obtainable, long-term, fixed rate debt has or will be arranged. Other properties with below market rents or a substantial vacancy are financed under short-term extendable interim credit facilities. Interim credit facilities are generally floating rate debt but may be hedged for interest rate protection. During the period that properties are financed with interim debt, the Company carefully monitors the cost and availability of long-term debt and is prepared to obtain forward commitments for fixed rate debt if upward rate movement appears likely.

Based on its current debt to equity ratio, the Company believes it has additional capacity to increase its leverage.

#### CAPITAL RESOURCES AND LIQUIDITY

Cash flow from operations was \$19.9 million, or \$0.66 per share, for the year ended January 31, 1998, as compared to \$13.2 million, or \$0.54 per share, for the prior year, reflecting the impact of acquisitions made during the year and reduced financing costs.

As of May 1998, the Company had commitments to acquire properties under agreements of purchase and sale totaling approximately \$142 million. Approximately \$17 million will be funded from the proceeds of the refinancing of two of the Company's office buildings, \$18 million from cash on hand and the balance from debt and capital stock to be issued. The Company's interest in 5140 Yonge Street represents a significant unencumbered asset which may be used to raise additional capital in the near-term.

The Company believes that its existing resources, cash flow from operations and ability to refinance existing and maturing debt, together with its ability to raise additional equity financing, as required, will be sufficient to fund its capital requirements over the coming year.

#### **LEASING AND REAL ESTATE SERVICES CONTRACT RISKS**

The real estate ownership business is competitive and cyclical. Numerous other developers, managers and owners of office and retail properties compete with the Company in seeking tenants, real estate services contracts and, for its nonstrategic properties, prospective purchasers. The supply of space and the demand for real estate in local markets affects the attractiveness of properties to current and prospective tenants, and thus the Company's ability to lease vacant space and renew existing tenancies at viable net effective rents. The Company believes it has a competitive advantage through the market knowledge that results from its network of real estate services operations, thus decreasing this risk.

The Company's property portfolio has diversified in the past year both geographically and in tenant base. This reduces the risk of a downturn in any one particular market, as well as the risk associated with any one tenant not renewing its lease. The Company's growth strategy will continue this diversification.

The profitability of the real estate services business is subject to potential margin pressure from increased competition and the loss of real estate services contracts. However, the provision of real estate services is significantly less capital intensive than property ownership and provides a stable fee-based income. The infrastructure required to provide large scale property real estate services is a barrier to entry for others, giving the Company a competitive advantage.

#### **YEAR 2000**

Certain computer programs and microprocessors use two digits rather than four to define the applicable year. Any computer programs that have date-sensitive software and microprocessors may recognize a date using "00" as the year 1900 rather than the year 2000 and thus programming changes and testing of such computer applications is required. This phenomenon (the "Year 2000 Issue") could cause a disruption to the Company's operations. If not corrected, a temporary inability to engage in normal business activities such as providing services to tenants for elevators, lighting and fire safety could result. In conjunction with suppliers and others, the Company has committed internal and external resources to address the Year 2000 Issue. Responsibilities have been assigned and timetables established to analyze, modify and test any programs affected. The Company expects to complete the modifications and conversions on a timely basis without significant costs or disruption. Testing of all areas affected is expected to be completed before the end of 1998 and acquisitions will be monitored closely for compliance. The Company has also communicated with customers to determine the extent to which the Company may be vulnerable to these parties' failure to remedy their own Year 2000 Issues. Management believes that the Year 2000 Issue will not have a material adverse impact on the Company's future results of operations or financial condition.

#### **OUTLOOK**

In fiscal 1999 we expect some moderation in property prices as more properties are brought to the market. Acquisition opportunities will be available particularly for those entrepreneurial enough to be flexible and responsive to criteria important to vendors. Our expanded deal and market knowledge network, combined with the ability to put together creative, financially engineered transactions, give us a competitive edge. We will continue creating value through acquisitions of income-producing office and mixed-use properties that are accretive to earnings and cash flow.

Increased demand for quality office space has pushed net effective rental rates to levels at which new development becomes feasible. We will supplement our income-producing property acquisition strategy with selective development, most likely beginning in downtown Toronto where we already have a development ready site.

Capital upgrades to our existing properties will be undertaken where necessary to reposition them in the marketplace and create further value. The recent expansion of our real estate services group provides a solid platform from which to enhance profits through additional services and new contracts in the commercial, retail, industrial and public facilities sectors.

All of these strategies will be undertaken in conjunction with a financing approach that maintains conservative leverage.

It is on this basis that the Company believes its growing portfolio of properties will continue to result in the long-term creation of value to shareholders.

INDEPENDENT CHARTERED ACCOUNTANTS' REPORT TO SHAREHOLDERS

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To the Shareholders of O&Y Properties Corporation:

We have audited the consolidated balance sheets of O&Y Properties Corporation as at January 31, 1998 and 1997 and the consolidated statements of earnings and retained earnings, cash flow from operations and changes in financial position for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at January 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

*Deloitte & Touche*

Deloitte & Touche  
Chartered Accountants

Toronto, Ontario, Canada  
May 12, 1998

**CONSOLIDATED FINANCIAL STATEMENTS**  
**CONSOLIDATED BALANCE SHEET**

| As at January 31 (in thousands of dollars)      | Notes | 1998                    | 1997                 |
|---|-------|-------------------------|----------------------|
| <b>ASSETS</b>                                   |       |                         |                      |
| Rental properties                               | 4.5   | \$ 490,942              | 241,835              |
| Properties under development                    | 5     | —                       | 2,799                |
| Land held for sale or development               | 5     | 8,383                   | 13,909               |
| Real estate services contracts                  |       | 11,627                  | —                    |
| Amounts receivable                              |       | 8,824                   | 2,994                |
| Other assets and deferred costs                 |       | 2,480                   | 711                  |
| Cash and short-term investments                 | 6     | 54,479                  | 8,382                |
|   |       | <hr/> <b>\$ 576,735</b> | <hr/> <b>270,630</b> |
| <b>LIABILITIES</b>                              |       |                         |                      |
| Secured debt                                    | 8     | \$ 263,974              | 151,459              |
| Accounts payable and accrued liabilities        |       | 32,049                  | 10,962               |
| Preferred shares and notes, liability component | 9     | 17,505                  | —                    |
|   |       | <hr/> <b>313,528</b>    | <hr/> <b>162,421</b> |
| <b>SHAREHOLDERS' EQUITY</b>                     |       |                         |                      |
| Preferred shares and notes, equity component    | 9     | 18,191                  | —                    |
| Common shares                                   | 10    | 214,979                 | 96,200               |
| Retained earnings                               |       | 30,037                  | 12,009               |
|   |       | <hr/> <b>263,207</b>    | <hr/> <b>108,209</b> |
| Commitments and contingencies                   | 14    |                         |                      |
|   |       | <hr/> <b>\$ 576,735</b> | <hr/> <b>270,630</b> |

*See accompanying notes to financial statements.*

*On behalf of the Board:*

Tibor Donath, Director

Maureen Sabia, Director

## CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS

Year ended January 31 (in thousands of dollars except per share amounts)

Notes

1998

1997

## REVENUES

|                           |           |        |
|---------------------------|-----------|--------|
| Rental property           |           |        |
| Office and mixed use      | \$ 64,911 | 52,610 |
| Hotel and shopping centre | 2,289     | 11,068 |
| Real estate services      | 17,372    | 4,128  |
|                           | <hr/>     | <hr/>  |
|                           | 84,572    | 67,806 |

## EXPENSES

|  |        |        |
|--|--------|--------|
| Rental property operating expenses and taxes |        |        |
| Office and mixed use                         | 32,044 | 23,942 |
| Hotel and shopping centre                    | 829    | 6,361  |
| Real estate services                         | 15,872 | 3,537  |
|  | <hr/>  | <hr/>  |

## RENTAL AND REAL ESTATE SERVICES INCOME

|                               |        |        |
|-------------------------------|--------|--------|
| Financing expense             | 12,821 | 17,596 |
| Corporate expense             | 2,238  | 2,610  |
| Depreciation and amortization | 4,833  | 3,088  |
|                               | <hr/>  | <hr/>  |

## INCOME BEFORE THE UNDERTONED ITEMS

|                               |       |       |       |
|-------------------------------|-------|-------|-------|
| Gain on disposition of assets | 7     | 3,547 | 1,892 |
| Income tax expense            | 11    | 1,172 | 555   |
|                               | <hr/> | <hr/> | <hr/> |

## NET INCOME FOR THE YEAR

|  |       |        |       |
|--|-------|--------|-------|
| Retained earnings, beginning of year   |       | 12,009 | -     |
| Accretion on equity component of preferred shares and notes (Net of tax of \$64, 1997-Nil) | 9     | 282    | -     |
|  | <hr/> | <hr/>  | <hr/> |

## RETAINED EARNINGS, END OF YEAR

|                           |         |      |  |
|---------------------------|---------|------|--|
| EARNINGS PER COMMON SHARE | 9,10    |      |  |
| Basic                     | \$ 0.60 | 0.49 |  |
| Fully diluted             | \$ 0.59 | 0.49 |  |

*See accompanying notes to financial statements.*

## CONSOLIDATED STATEMENT OF CASH FLOW FROM OPERATIONS

| <i>Year ended January 31 (in thousands of dollars except per share amounts)</i> | <i>Notes</i> | <i>1998</i>      | <i>1997</i>   |
|---|--------------|------------------|---------------|
| <b>NET INCOME</b>   |              | <b>\$ 18,310</b> | <b>12,009</b> |
| <b>NON-CASH ITEMS:</b>  |              |                  |               |
| Depreciation and amortization   |              | 4,833            | 3,088         |
| Other   |              | 340              | -             |
| <b>NON-OPERATING ITEMS:</b>   |              |                  |               |
| Gain on disposition of assets   | 7            | (3,547)          | (1,892)       |
| <b>CASH FLOW FROM OPERATIONS</b>  |              | <b>\$ 19,936</b> | <b>13,205</b> |
| <b>CASH FLOW FROM OPERATIONS PER COMMON SHARE</b>                               | 10           |                  |               |
| Basic   |              | \$ 0.66          | 0.54          |
| Fully diluted   |              | \$ 0.65          | 0.54          |

*See accompanying notes to financial statements.*

## CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

| <i>Year ended January 31 (in thousands of dollars)</i>      | <i>Notes</i> | <i>1998</i>      | <i>1997</i>      |
|---|--------------|------------------|------------------|
| <i>inflows (outflows)</i>                                   |              |                  |                  |
| <b>OPERATING ACTIVITIES</b>                                 |              |                  |                  |
| Cash flow from operations                                   |              | \$ 19,936        | 13,205           |
| Net change in operating working capital                     |              | 5,391            | (1,859)          |
| Tenant inducements on rental properties                     |              | (4,132)          | (552)            |
| <b>TOTAL OPERATING ACTIVITIES</b>                           |              | <b>21,195</b>    | <b>10,794</b>    |
| <b>FINANCING ACTIVITIES</b>                                 |              |                  |                  |
| Cash proceeds of bond issue                                 |              | 110,000          | —                |
| Other debt issued for cash                                  |              | 5,554            | 1,366            |
| Debt assumed to finance acquisitions                        |              | 103,118          | —                |
| Regular principal repayments                                |              | (16,240)         | (8,100)          |
| Debt repaid from proceeds of bond issue                     |              | (90,431)         | —                |
| Debt repaid from proceeds of asset dispositions             |              | —                | (98,290)         |
| Debt issue costs  |              | (1,368)          | —                |
| Issue of common shares and special warrants for cash        |              | 105,811          | —                |
| Issue of common shares to finance acquisitions              |              | 40,796           | —                |
| Issue costs of shares and special warrants                  |              | (7,836)          | —                |
| Repurchase of shares for cancellation                       |              | (19,992)         | —                |
| Issue of preferred shares and notes to finance acquisitions |              | 35,600           | —                |
| <b>TOTAL FINANCING ACTIVITIES</b>                           |              | <b>265,012</b>   | <b>(105,024)</b> |
| <b>INVESTMENT ACTIVITIES</b>                                |              |                  |                  |
| Purchase of rental properties, including working capital    |              | (239,144)        | —                |
| Expenditures on rental properties                           |              | (1,540)          | (349)            |
| Expenditures on properties under development                |              | (1,392)          | (1,635)          |
| Expenditures on land held for sale or development           |              | (1,192)          | (535)            |
| Acquisition of real estate services business                |              | (12,552)         | —                |
| Notes and other amounts receivable, net                     |              | (391)            | 6,646            |
| Proceeds from the sale of land                              |              | 10,265           | —                |
| Proceeds from sale of rental properties                     |              | —                | 98,727           |
| Other   |              | 5,836            | (1,266)          |
| <b>TOTAL INVESTMENT ACTIVITIES</b>                          |              | <b>(240,110)</b> | <b>101,588</b>   |
| <b>FINANCIAL REORGANIZATION</b>                             |              |                  | 15               |
| Costs incurred on reorganization                            |              | —                | (2,464)          |
| <b>TOTAL FINANCIAL REORGANIZATION</b>                       |              | <b>—</b>         | <b>(2,464)</b>   |
| Increase in cash during year                                |              | 46,097           | 4,894            |
| Cash – beginning of year                                    |              | 8,382            | 3,488            |
| Cash – end of year  |              | <b>\$ 54,479</b> | <b>8,382</b>     |

*Cash comprises cash and short-term investments. See accompanying notes to financial statements.*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(all tabular amounts stated in thousands of dollars unless otherwise noted)

### I. BASIS OF PRESENTATION

O&Y Properties Corporation is incorporated under the Business Corporations Act (Ontario). On July 31, 1997 O&Y Properties Corporation changed its name from Camdev Corporation.

On February 1, 1996, the Corporation completed a significant restructuring of its debt and equity which has been reflected in the financial statements as a financial reorganization in accordance with generally accepted accounting principles. As a result, the Corporation's assets and liabilities have been subject to a comprehensive revaluation and the consolidated balance sheet has been presented on a "fresh start" basis as at January 31, 1996, as further described in note 15.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the recorded amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### (a) General

The Corporation's accounting policies and standards of financial disclosure are in accordance with generally accepted accounting principles in Canada and are also substantially in accordance with the recommendations of the Canadian Institute of Public Real Estate Companies, of which O&Y Properties Corporation is a member.

#### (b) Consolidation

The consolidated financial statements include the accounts of O&Y Properties Corporation, its principal subsidiary O&Y Properties Inc., and the proportionate share of assets, liabilities, revenues and expenses of its joint ventures.

#### (c) Rental properties

Rental properties include land, buildings, improvements, furniture and equipment and deferred costs related to leasing and maintaining the rental properties.

Rental properties are carried at the lower of cost less accumulated depreciation and net recoverable amount. The net recoverable amount for each of the Corporation's rental properties represents the undiscounted estimated future cash flow expected to be received from the ongoing use of the property and its residual worth.

Depreciation on buildings and improvements, including initial leasing costs, is provided using the sinking fund method in annual amounts increasing at the rate of 5% compounded annually, which is designed to fully amortize the cost of the buildings and improvements over their estimated useful lives, which range from 30 to 50 years.

Amortization of re-leasing costs is provided using the straight line method over the terms of tenant lease agreements.

#### (d) Land held for sale or development

Land held for sale is recorded at the lower of cost plus applicable carrying costs and estimated net realizable value. The net realizable value of the Corporation's land held for sale represents the discounted future net cash flow expected to be received from sale.

Land held for development is recorded at the lower of cost plus applicable carrying costs and net recoverable amount.

#### (e) Revenue recognition

Revenue from a rental property is recognized once a property is deemed to be completed. Completion is deemed to occur once a break-even point in operating cash flow is attained, subject to a reasonable maximum period of time or level of occupancy. Prior to achieving this level of cash flow, properties are classified as properties under development and revenue therefrom is treated as a deduction from the development cost.

Revenue from a real estate sale is recognized once all material conditions have been satisfied and collection of the sales proceeds is reasonably assured.

Revenue from managing and leasing commercial real estate is recognized when earned. Design and construction revenue is recognized on a percentage of completion basis.

*(f) Real estate services contracts*

Real estate services contracts are recorded at the lower of cost net of accumulated amortization and the estimated net recoverable amount. Real estate services contracts are amortized on a straight-line basis over the estimated lives of the contracts.

*(g) Capitalization of costs*

The cost of land held for sale or development and properties under development includes interest on both specific and general debt, property taxes and general and administrative expenses incurred directly in connection with the acquisition, development and redevelopment of properties.

### 3. ACQUISITIONS

*(a)* On May 29, 1997, the Corporation acquired O&Y Properties Inc., a corporation providing third-party real estate services, from a significant shareholder at an exchange amount of \$1.5 million, and 7,996,625 common shares of the Corporation previously held by Citibank Canada at an exchange amount of \$35.3 million. The consideration given consisted of the assumption of debt of \$26 million and the issuance of 4,498,312 common shares of the Corporation for \$24.3 million. The Corporation cancelled the 7,996,625 common shares previously held by Citibank Canada and repaid the assumed indebtedness from proceeds of a common share offering (note 10). Immediately prior to this transaction, a 40% interest in O&Y Properties Inc. was purchased by the significant shareholder from an arm's length party for \$6 million.

On May 29, 1997, the Corporation also acquired for cash consideration a 51.25% interest in a promissory note secured by a leasehold mortgage of the income-producing property known as 5140 Yonge Street, Toronto, Ontario at an exchange amount of \$21.1 million (equal to the vendor's cost) from a vendor that is a partner in the Corporation's significant shareholder group. A director and officer of the Corporation has a significant interest in the vendor. The promissory noteholders, including the Corporation, went into possession and commenced foreclosure proceedings to convert their interest in the note into a direct leasehold interest in the underlying income-producing property. Subsequent to year end, there was an attempt to convert the proceedings into a judicial sale that could result in a disposition of the property. The Corporation has resisted these actions. In the event of a judicial sale to other than the Corporation, a gain of approximately \$19 million on its original \$21 million investment would result.

The acquisitions have been accounted for using exchange amounts as follows:

|                                     |           |
|-------------------------------------|-----------|
| Rental properties                   | \$ 20,486 |
| Real estate services contracts      | 12,552    |
| Cash and other working capital, net | 3,028     |
|                                     | \$ 36,066 |

*(b)* On September 25, 1997, the Corporation acquired three office buildings in Toronto for total consideration of \$81 million consisting of: \$16.6 million in cash; \$22.5 million by way of assumption of mortgages; \$28 million of convertible and exchangeable securities; \$7.6 million of preferred shares of a subsidiary, with no dividend requirement, \$6 million of which are redeemable on September 28, 1998, and \$1.6 million of which are redeemable on September 25, 2007; and \$6.3 million by way of issuance of 1,013,334 common shares of the Corporation.

*(c)* On November 10, 1997, the Corporation acquired a 149,000 square foot office building in downtown Niagara Falls, Ontario for total consideration of \$6.35 million, which was satisfied by way of \$4.5 million in first mortgage financing and \$1.85 million in cash.

*(d)* On December 16, 1997, the Corporation entered into a binding agreement to acquire all of the shares of a holding company that owns a 28% interest in First Place Tower Inc. ("FPTI"). FPTI has a 50% freehold and a 50% leasehold interest in the land and a 100% ownership interest in the building comprising Phase 1 of the First Canadian Place office, retail and banking complex in Toronto. The leasehold interest in the complex terminates in 2023, following which FPTI will retain a 50% freehold interest in the land and building. The acquisition was recorded effective January 8, 1998 for total consideration of \$61.6 million consisting of \$29.2 million in cash and 2,644,095 common shares of the Corporation valued at \$25.5 million, both paid

to unrelated parties, and a \$6.9 million obligation to related parties which was at the exchange amount. Subsequent to year end, 721,786 common shares were issued to the related parties in settlement of the obligation. The acquisition has been accounted for on a proportionate consolidation basis as follows:

|                                     |            |
|-------------------------------------|------------|
| Rental properties                   | \$ 130,374 |
| Cash and other working capital, net | 6,742      |
| Secured debt                        | (75,491)   |
|                                     |            |
|                                     | \$ 61,625  |

#### 4. RENTAL PROPERTIES

| January 31                                       | 1998       | 1997    |
|--|------------|---------|
| Land   | \$ 70,092  | 32,930  |
| Buildings, improvements and other deferred costs | 423,209    | 208,642 |
| Furniture and equipment                          | 3,726      | 2,864   |
|  |            |         |
| Less accumulated depreciation                    | 497,027    | 244,436 |
|  | 6,085      | 2,601   |
|  |            |         |
|  | \$ 490,942 | 241,835 |

#### 5. CAPITALIZED EXPENSES

| January 31   | 1998     | 1997 |
|--|----------|------|
| During the year the following expenses were capitalized: |          |      |
| Property taxes   | \$ 674   | 551  |
| Operating expenses – net                                 | 557      | 86   |
|  |          |      |
|  | \$ 1,231 | 637  |
| These amounts were capitalized as follows:               |          |      |
| Rental properties  | \$ 39    | 54   |
| Properties under development                             | –        | 48   |
| Land held for sale or development                        | 1,192    | 535  |
|  |          |      |
|  | \$ 1,231 | 637  |

#### 6. CASH AND SHORT-TERM INVESTMENTS

Included in cash is \$16.2 million held, in part, pursuant to the terms of joint venture arrangements and, in part, under the terms of a trust indenture governing an issue of bonds.

#### 7. GAIN ON DISPOSITION OF ASSETS

During the year ended January 31, 1998, the Corporation disposed of a 180 acre land parcel and a 44 acre land parcel in Kanata, Ontario for proceeds of \$10.3 million which resulted in a net gain of approximately \$3.5 million.

During the year ended January 31, 1997, the Corporation realized \$6.2 million from the settlement of a claim which resulted in a gain of \$1.9 million.

#### 8. SECURED DEBT

|   | Interest Rates at January 31, 1998 |                       |  | Total January 31 |         |
|---|------------------------------------|-----------------------|--|------------------|---------|
|   | Range<br>%-%                       | Weighted<br>average % | Long-term debt<br>maturing in years<br>ending January 31 | 1998             | 1997    |
| Fixed rate debt                           | 5.63-10.69                         | 7.47                  | 1999-2005  | \$ 172,615       | 12,962  |
| Floating rate debt                        | 6.00-8.95                          | 7.49                  | 1999-2001  | 91,359           | 47,250  |
| Loans from shareholder –<br>floating rate |                                    |                       |  | 1998             | –       |
|   |                                    |                       |  |                  | 91,247  |
|   |                                    |                       |  |                  |         |
|   |                                    |                       |  | \$ 263,974       | 151,459 |

Debt balances at January 31, 1998 are due as follows:

| <i>Years ending January 31</i> | <i>Instalment payments</i> | <i>Balance due at maturity</i> | <i>Total</i>   |
|--------------------------------|----------------------------|--------------------------------|----------------|
| 1999                           | \$ 16,838                  | 13,720                         | 30,558         |
| 2000                           | 13,873                     | 58,576                         | 72,449         |
| 2001                           | 14,457                     | 35,000                         | 49,457         |
| 2002                           | 15,438                     | —                              | 15,438         |
| 2003                           | 15,744                     | 7,476                          | 23,220         |
| Thereafter                     | 22,322                     | 50,530                         | 72,852         |
|                                | <b>\$ 98,672</b>           | <b>165,302</b>                 | <b>263,974</b> |

Substantially all of the Corporation's assets have been pledged as security under the various debt agreements.

#### 9. PREFERRED SHARES AND NOTES

| <i>January 31</i>                                    | <i>Liability</i> | <i>Equity</i> | <i>1998</i>   | <i>1997</i>  |
|--|------------------|---------------|---------------|--------------|
|  |                  |               | <i>Total</i>  | <i>Total</i> |
| Series 1 redeemable preferred shares of a subsidiary | \$ 6,000         | —             | 6,000         | —            |
| Series 2 redeemable preferred shares of a subsidiary | 1,600            | —             | 1,600         | —            |
| Series 1 convertible preferred shares                | 4,729            | 10,325        | 15,054        | —            |
| Exchangeable notes of a subsidiary                   | 5,176            | 7,866         | 13,042        | —            |
|  | <b>\$ 17,505</b> | <b>18,191</b> | <b>35,696</b> | <b>—</b>     |

The Corporation is authorized to issue an unlimited number of preference shares. The preference shares are non-voting, issuable in series, each series ranking equally, and are senior to the common shares.

The aggregate amount of the 4.44% Series 1 convertible preferred shares (the "Preferred Shares") is \$15 million (600,000 shares). The Preferred Shares are redeemable on September 25, 2007, convertible into common shares of the Corporation at \$8.25 at the option of the holder and redeemable under certain conditions at the option of the Corporation after September 25, 2002 (or after September 25, 2000 if the market price of the Corporation's common shares exceeds \$10.31) in cash or common shares.

The aggregate principal amount of the notes of a subsidiary (which are exchangeable into 6% convertible debentures or common shares of the Corporation) (the "Notes") is \$13 million. The Notes are redeemable and convertible on substantially the same terms as the Preferred Shares.

The Preferred Shares and Notes represent financial instruments that may be settled at the issuer's option in cash or its own equity instruments. Accordingly, the obligation to make cash payments on account of interest is reflected as a liability (at the net present value of such payments) with the remaining amount, being the present value of the principal portion of the security, reflected as equity.

The liability component of the Preferred Shares and Notes is calculated as the present value of the future interest payments and is increased for the accretion of the discount each year to reflect the time value of money and reduced by cash payments of interest. The accretion is reflected as financing expense in the consolidated statement of earnings and retained earnings. The ongoing accretion of the equity component, which will increase this component from its initial carrying amount to the stated principal amount of the Preferred Shares and Notes, is reflected as a charge to retained earnings, net of income taxes. In computing earnings per common share, these charges to retained earnings are deducted from earnings available to common shareholders.

The 1,000,000 outstanding Series 1 redeemable preferred shares of a subsidiary are non-dividend bearing and are redeemable September 25, 1998. The 1,600 outstanding Series 2 redeemable preferred shares of a subsidiary are non-dividend bearing and are redeemable September 25, 2001.

#### 10. COMMON SHARES

The Corporation is authorized to issue an unlimited number of preference and common shares. The common shares entitle the holder to one vote per share.

There are 40,709,609 (1997 - 24,266,233) common shares issued and outstanding at January 31, 1998.

During the year the following common share transactions occurred:

|   | Number of Shares |            |
|---|------------------|------------|
| January 31, 1997  | 24,266,233       | \$ 96,200  |
| (a) May 29, 1997 public offering (net of issue costs)                                     | 9,409,260        | 46,352     |
| (b) May 29, 1997 issuance on acquisition of<br>O&Y Properties Inc.                        | 4,498,312        | 9,000      |
| (c) May 29, 1997 cancellation (Note 3(a))   | (7,996,625)      | (19,992)   |
| (d) September 25, 1997 issuance on acquisition of<br>rental properties                    | 1,013,334        | 6,333      |
| (e) December 8, 1997 issuance upon conversion of<br>special warrants (net of issue costs) | 6,875,000        | 51,623     |
| (f) January 8, 1998 issuance on acquisition of interest<br>in First Place Tower Inc.      | 2,644,095        | 25,463     |
| January 31, 1998  | <hr/>            | <hr/>      |
|   | 40,709,609       | \$ 214,979 |

During the year, the Corporation granted options to purchase 635,000 common shares of the Corporation (575,000 at \$7.92 and 60,000 at \$8.75) per share pursuant to the Corporation's incentive stock option plan, none of which have been exercised.

On October 10, 1997, the Corporation issued 6,875,000 special warrants at \$8.00 per warrant for \$51.6 million in cash net of issue costs. On December 8, 1997, the warrants were converted into an equivalent number of shares.

Per share amounts are calculated using the weighted average number of common shares outstanding during the year which is 29,832,411 (1997 - 24,266,233). On a fully diluted basis the weighted average number of common shares outstanding during the year is 31,277,820 (1997 - 24,266,233).

Due to the financial reorganization that took place effective January 31, 1996, the capital stock amount for accounting purposes differs from the legal stated capital amount.

#### II. INCOME TAXES

The Corporation has non-capital tax losses eligible to be carried forward of \$57 million (\$61 million as at January 31, 1997) which are available to offset future taxable income subject to their expiry in the years 2002 (\$40 million) and 2003 (\$17 million). The benefit for accounting purposes of tax losses totalling \$31.2 million (1997 - \$45.3 million) has not been reflected in the financial statements.

A reconciliation between the income tax computed on pre-tax income at statutory rates and the actual provision for income taxes is as follows:

| Year ended January 31  | 1998      | 1997    |
|--|-----------|---------|
| Net income before income taxes                                 | \$ 19,482 | 12,564  |
| Non-taxable portion of (income) loss from capital gains/losses | (887)     | 1,425   |
| Other permanent differences                                    | 63        | 64      |
| <hr/>  | <hr/>     | <hr/>   |
| Income tax at statutory rates                                  | \$ 8,321  | 6,267   |
| Benefit from utilization of losses carried forward             | (8,321)   | (6,267) |
| Large corporations tax and corporate minimum tax               | 1,172     | 555     |
| <hr/>  | <hr/>     | <hr/>   |
|  | \$ 1,172  | 555     |

**12. SEGMENTED INFORMATION**

| <i>Year ended January 31, 1998</i>     | <i>Office and Mixed Use</i> | <i>Hotel and Shopping Centre</i> | <i>Real Estate Services</i> | <i>Total</i> |
|--|-----------------------------|----------------------------------|-----------------------------|--------------|
| Operating revenues                     | \$ 64,911                   | 2,289                            | 17,372                      | 84,572       |
| Operating expenses                     | 32,044                      | 829                              | 15,872                      | 48,745       |
| Rental and real estate services income | 32,867                      | 1,460                            | 1,500                       | 35,827       |
| Depreciation and amortization          | 3,612                       | 117                              | 1,104                       | 4,833        |
| Operating income                       | \$ 29,255                   | 1,343                            | 396                         | 30,994       |
| Identifiable segment assets as at      |                             |                                  |                             |              |
| January 31, 1998                       | \$497,424                   | 8,507                            | 16,325                      | 522,256      |
| January 31, 1997                       | \$253,024                   | 8,616                            | 608                         | 262,248      |
| <i>Year ended January 31, 1997</i>     |                             |                                  |                             |              |
| Operating revenues                     | \$ 52,610                   | 11,068                           | 4,128                       | 67,806       |
| Operating expenses                     | 23,942                      | 6,361                            | 3,537                       | 33,840       |
| Rental and real estate services income | 28,668                      | 4,707                            | 591                         | 33,966       |
| Depreciation and amortization          | 2,564                       | 524                              | —                           | 3,088        |
| Operating income                       | \$ 26,104                   | 4,183                            | 591                         | 30,878       |

Operating income comprises net income excluding financing expense, corporate expense, gain on disposition of assets and income tax expense. Revenues and expenses for the year ended January 31, 1998 are after inter-segment eliminations. Identifiable segment assets exclude cash and short-term investments.

**13. JOINT VENTURES**

The consolidated financial statements include the Corporation's proportionate interest in its activities conducted jointly with other parties:

| <i>January 31</i>                 | <i>1998</i> | <i>1997</i> |
|-----------------------------------|-------------|-------------|
| Assets                            | \$ 156,590  | —           |
| Liabilities                       | 49,357      | —           |
| Revenues                          | 6,789       | —           |
| Expenses                          | 5,260       | —           |
| Net income                        | 1,529       | —           |
| Cash flow from operations         | 2,004       | —           |
| Cash used in investing activities | 134         | —           |

The Corporation is contingently liable for certain of the joint venture obligations of its co-venturers in the joint ventures and the assets of the joint ventures are sufficient for the purpose of satisfying such obligations.

**14. COMMITMENTS AND CONTINGENCIES**

The Corporation has obligations as lessee under long-term leases for land up to the year 2067. Payments made under ground leases are classified as financing expense. Other leases for office facilities and equipment exist for periods not exceeding five years. The leases for land and office facilities generally contain escalation clauses requiring adjustment of rents at various dates and provide for the payment of real estate taxes and other expenses. Future minimum lease payments, excluding executory costs under long-term leases as at January 31, 1998, are \$3.7 million per year for the years ending January 31, 1999 through 2003 and total \$180 million for all subsequent years.

The Corporation is involved in litigation and claims which arise from time to time in the normal course of business. In the opinion of management, none of these, individually or in the aggregate, would result in liability that would have a significant adverse effect on the financial position of the Corporation.

**15. FINANCIAL REORGANIZATION AND COMPREHENSIVE REVALUATION**

On January 31, 1996, the Corporation's assets and liabilities were comprehensively revalued as the result of a financial reorganization and the application of "fresh start" accounting. The revaluation adjustment of \$152.0 million, including the elimination of a deficit of \$14.2 million, was classified as common shares.

## **16. FINANCIAL INSTRUMENTS**

The Corporation is exposed to financial risks arising from fluctuations in interest rates which could cause a variation in earnings. The Corporation has no foreign exchange risk because it holds only Canadian dollar denominated assets and liabilities. The Corporation has not entered into any contracts involving derivative financial instruments.

### *Interest Rate Risk*

A portion of the Corporation's debt is at floating rates and, as a result, the Corporation is exposed to changes in interest rates. Increases or decreases in these rates would decrease or increase the Corporation's earnings. As part of its risk management program, the Corporation endeavors to maintain an appropriate mix of fixed rate and floating rate debt and strives to match the nature and timing of lease inflows to financing thereon (note 8).

### *Fair Value*

Fair values of financial assets and liabilities approximate amounts at which these instruments could be exchanged in a transaction between knowledgeable and willing parties. Where available, such as in the case of the Corporation's debt, public market information is used to express the fair value. When such information is not readily available, fair value is estimated using present value techniques and assumptions concerning the amount and timing of expected future cash flows and discount rates which reflect the appropriate level of risk for the instrument. The estimated fair values may differ in amount from that which could be realized in an immediate settlement of the instruments. As at January 31, 1998, the estimated fair value of the Corporation's secured debt at prevailing market interest rates is \$273.5 million and the fair value of the Corporation's preferred shares and notes approximates their carrying value.

## **17. RELATED PARTY TRANSACTIONS**

In addition to those transactions identified in note 3, during the year ended January 31, 1998 the Corporation paid \$1,207,000 (1997-\$8.1 million) to Citibank, a former significant shareholder, on account of financing expenses related to a bridge loan.

In the prior year, pursuant to an advisory services agreement between the Corporation and a company associated with a former director who was nominated by the former principal shareholder of the Corporation, the Corporation paid \$489,000 to the associated company and recorded the amount as corporate expense. The agreement has been terminated.

## **18. SUBSEQUENT EVENTS**

(a) On April 14, 1998, the Corporation entered into an agreement to acquire Enterprise Property Group ("Enterprise"), a privately-owned manager of third party commercial properties. Enterprise's portfolio of commercial, industrial and residential management contracts total approximately 50 million square feet.

The purchase price of \$18 million is to be satisfied through the payment of cash and approximately 897,000 common shares issued at \$9.75 per share. The agreement includes additional performance-based consideration designed to increase the purchase price by up to \$6.0 million through the issue of additional common shares if certain performance thresholds are met in each of the next three years.

(b) On April 24, 1998, the Corporation entered into an agreement to acquire a Western Canada portfolio of properties for total consideration of \$96 million. Expected consideration is comprised of \$14 million of cash, \$60 million of debt and \$22 million through the issuance of common shares.

The portfolio consists of approximately 1 million square feet in Calgary, Alberta and Winnipeg, Manitoba and real estate services contracts for approximately 1 million square feet of properties in Manitoba.

(c) On March 23, 1998, the Corporation entered into an agreement to acquire a 50% interest in a 305,000 square foot office building in Calgary, Alberta for total consideration of \$27.5 million. Expected consideration consists of \$10 million of cash and \$17.5 million of debt.

(d) On April 1, 1998, the Corporation sold its 411 room Citadel Inn. Situated within the Place de Ville complex in Ottawa, Citadel Inn was sold for cash proceeds of \$19.8 million, resulting in a gain on sale of approximately \$10.6 million.

## **19. COMPARATIVE AMOUNTS**

Certain comparative amounts have been reclassified to conform with the presentation for the current year.

## CORPORATE DIRECTORY AND INVESTOR INFORMATION

**DIRECTORS**

**TIBOR DONATH**  
Partner  
*Bench & Donath*  
Toronto, Ontario

**ABRAHAM FRUCHTHANDLER**  
General Partner  
*FBE Limited*  
New York, New York

**STANLEY H. HARTT, O.C., Q.C.**  
Chairman  
*Salomon Smith Barney Canada Inc.*  
Toronto, Ontario

**FRANK HAUER**  
President  
*O&Y Properties Corporation*  
Toronto, Ontario

**THE HONOURABLE MARC LALONDE, P.C., O.C., Q.C.**  
Senior Partner  
*Stikeman, Elliott*  
Montreal, Quebec

**PHILIP REICHMANN**  
Chief Executive Officer  
*O&Y Properties Corporation*  
Toronto, Ontario

**MAUREEN SABIA**  
President  
*Maureen Sabia International*  
Toronto, Ontario

**ALBERT SCHONKOPF**  
President  
*Crown Group of Companies*  
New York, New York

**CORPORATE OFFICERS**

**STANLEY H. HARTT**  
*Chairman of the Board*

**PHILIP REICHMANN**  
*Chief Executive Officer*

**FRANK HAUER**  
*President*

**RACHUNATH DAVLOOR**  
Senior Vice-President,  
*Investments*

**DALE KEARNS**  
Senior Vice-President, Finance  
and Chief Financial Officer

**JOHN LEVITT**  
Senior Vice-President,  
Business Development

**RANDY NORTHEY**  
Senior Vice-President,  
General Counsel and Secretary

**JAN SUCHARD**  
Vice-President,  
Asset Management

**SUBSIDIARY COMPANY OFFICERS**

**CATHERINE STEFAN**  
Chief Operating Officer

**GEOFFREY HARRISON**  
Senior Vice-President and  
Managing Director,  
Real Estate Services

**RONALD TAYLOR**  
Senior Vice-President,  
Corporate Communications  
and Managing Director  
*O&Y/SMG Canada*

**MOSHE WERTHEIM**  
Senior Vice-President,  
Property Operations and Engineering  
and Managing Director  
*O&Y Contractors Inc.*

**GARY GRIFFITHS**  
General Manager, *O&Y*  
Services Immobiliers s.e.n.c.

**FRANK BUCYS**  
Vice-President, Finance

**GLENN FEATHERSTONE**  
Vice-President, Retail Leasing

**CELIA HITCH**  
Vice-President, Leasing Counsel

**REBECCA LEIGH**  
Vice-President, Office Leasing

**MARYANNE McDougald**  
Vice-President, Retail Operations

**DOROTHY POPOVSKI**  
Vice-President, Office Leasing

**FRED SPEER**  
Vice-President,  
National Capital Region

**JAMES WILSON**  
Vice-President, Office Operations

**STOCK LISTINGS**

The Common Shares of the Company are listed on the Toronto and Montreal stock exchanges under the symbol "OYP"

**TRANSFER AGENT AND REGISTRAR FOR COMMON SHARES**

CIBC Mellon Trust Company at its principal offices in Halifax, Montreal, Toronto, Winnipeg, Regina, Calgary and Vancouver.

**AUDITORS**

Deloitte & Touche Chartered Accountants  
Toronto, Ontario

**1998 CALENDAR OF FINANCIAL EVENTS**

Fiscal year end: January 31  
Quarter ends: April, July and October  
Quarterly reports: June, September and December  
Annual report: June  
Annual meeting: July

**FURTHER INFORMATION**

Shareholder inquiries may be addressed to, and copies of the Management Information Circular, Annual Information Form and Annual Report on Form 20-F may be obtained from, the Secretary, 40 King Street West Suite 2700  
Toronto, Ontario M5H 3Y2  
Telephone: (416) 365-2500

**ANNUAL AND SPECIAL MEETING**

An Annual and Special Meeting of Shareholders will be held at 11:00 a.m. Toronto time on Tuesday, July 21, 1998 at the Hilton Hotel, in the Toronto I Room, 145 Richmond Street West, Toronto, Ontario, Canada.



